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DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date: DEC 14 1999

OP:E:EO:T:4

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Contact Person:
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ID Number:
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Telephone Number:
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LEGEND

V = *
W = *
X = *
Y = *
Z = *

Dear Applicant:

This is in response to a ruling request dated June 7, 1999, on the application of sections 507(b)(2) and Chapter 42 of the Internal Revenue Code to a proposed asset transfer from X to Y.

FACTS

X is a private foundation as defined in Section 509(a) of the Internal Revenue Code of 1986, as amended from time to time, organized as a charitable trust under state law and exempt from taxation under 501(c)(3) of the Code. V and W established X in 1986 for the purpose of receiving, administering and distributing funds for charitable, religious, scientific, literary, educational and other Section 501(c)(3) purposes. V and W have been the primary source of funding since inception. V is currently the sole acting Trustee of X. W served as a co-Trustee of X until her death in 1998.

Immediately following the death of W, V formed Y. The current Trustees of Y are V, and his adult children. As with X, Y is a private foundation as defined in Section 509(a) of the Code, exempt from taxation under Section 501(c)(3) the Code. The Y was established for the purpose of receiving, administering and distributing funds for charitable, religious, scientific, literary, educational and other Section 501(c)(3) purposes.

In order to reduce the administrative burden and expense of maintaining two private foundations with identical charitable purposes, the Z family would like to consolidate X and Y. To achieve this end, V, as sole Trustee of X, requests permission to distribute all of the assets of X to Y so that all the funds can be administered together under the name of Y. Once X and Y have been consolidated, the Z family, working with a larger pool of assets earmarked for charity, can make more meaningful charitable gifts to preserve the legacy of W.

X has filed its Form 990-PF for the year ended June 30, 1998. It has satisfied the distribution requirements for all preceding years. X has carryover from prior years which will be transferred to Y. X is not currently under examination by the Internal Revenue Service.

The transfer by X of all its net assets to Y will be without consideration and will not be from current income. After the transfer, X will voluntarily terminate its private foundation status and will comply with the notification requirement and other requirements of Section 507 and 6033 of the Code. X will cease to exist after the transfer of its assets and the termination of its private foundation status.

Based upon the facts set forth above, and the assumption that the transaction will be carried out as previously described, X requests the following rulings:

1) The transfer by X of all its assets to Y will qualify as a Section 507(b)(2) transfer, and X's status as a private foundation will not terminate as a result of such transfer. Rather, X will be terminated for purposes of Section 507 when it complies with the notification and other requirements of Section 507(a)(1) of the Code the year in which it is dissolved.

2) Since X's private foundation status will not terminate as a result of the transfer, X will not be subject to any tax under Section 507(c) in the year of the transfer. Additionally, there will be no termination tax imposed under Section 507(c) of the Code upon X's termination in any tax year following the year in which the transfer is made.

3) Y, as the transferee organization, will not be treated as a newly created organization but will be treated, pursuant to Treasury Regulation Section 1.507-3(a)(1), as possessing the attributes and characteristics of X (as defined in Treasury Regulation Sections 1.507-3(a)(2), (3) and (4)). In addition, pursuant to Treasury Regulation Section 1.507-3(a)(5), the transfer by X to Y shall be counted as a qualifying distribution to the extent of X's current year's undistributed income and to the extent Y satisfies Section 4942(g) of the Code.

4) The transfer of assets from X to Y will not constitute an act of self-dealing within the meaning of Section 4941 of the Code between X and Y or their respective foundation managers.

5) The transfer of assets from X to Y will not constitute a taxable expenditure within the meaning of Section 4945(d) of the Code, and X will not be required to exercise expenditure responsibility as defined in Section 4945(h) of the Code with respect to such transfer of assets.

6) The transfer of assets from X to Y will not constitute a "sale or other disposition of property" within the meaning of Section 4940(c)(4)(A) of the Code.

LAW

Section 501(c)(3) of the Code provides for the exemption from federal income tax of nonprofit organizations "organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes ..." and other exempt purposes outlined in that section.

Section 509(a) of the Code provides that a 501(c)(3) organization is a private foundation unless it is described in section 509(a)(1), (2), (3) or (4) of the Code. Section 509(b) provides that a private foundation will continue as a private foundation unless such status is terminated under section 507 of the Code.

Section 507 of the Code describes certain voluntary and involuntary methods by which a private foundation will be deemed to be terminated for federal income tax purposes. With respect to the terminations described in section 507(a) of the Code, the termination tax described in section 507(c) of the

Code is imposed on the private foundation unless the Internal Revenue Service abates the tax pursuant to section 507(g) of the Code. Under section 507(a) of the Code, a private foundation may terminate its private foundation status only if it notifies the Service or it commits willful repeated acts, or a willful and flagrant act, which give rise to the imposition of a tax under Chapter 42 and it pays the termination tax or the Service abates the tax as mentioned above.

Section 507(b)(2) of the Code and section 1.507-3(a)(1) of the Income Tax Regulations indicate that, in a transfer of assets from one private foundation to one or more private foundations pursuant to any "liquidation, merger, redemption, recapitalization, or other adjustment, organization or reorganization" the transferee foundation shall not be treated as a newly-created organization.

Section 1.507-3(c) of the Income Tax Regulations provides that the terms "other adjustment, organization, or reorganization" used in section 507(b)(2) of the Code include any partial liquidation or any other significant disposition of assets to one or more private foundations, other than transfers for consideration or distributions out of current income.

Section 1.507-3(c)(2) of the regulations provides that a significant disposition of assets includes any disposition to one or more private foundations for the taxable year exceeding 25% of the fair market value of the assets of the transferor foundation at the beginning of the taxable year.

Section 1.507-4(b) of the regulations provides that the tax on termination of private foundation status imposed by section 507(c) of the Code does not apply to a transfer described in section 507(b)(2) of the Code unless section 507(a) of the Code is applicable.

Section 1.507-1(b)(6) and (7) of the regulations state that a transfer of all or part of a foundation's assets to one or more other private foundations, pursuant to section 507(b)(2) of the Code and section 1.507-3(c) of the regulations, will not result in termination of the transferor foundation's status as a private foundation.

Section 1.507-3(d) of the regulations provides that unless a private foundation elects to terminate and notifies the Service under section 507(a)(1) of the Code, a transfer of assets will not result in a termination of transferor's private foundation status.

Section 507(c) of the Code imposes a tax on terminating private foundations equal to the lower of the aggregate tax benefit or the value of its net assets.

Section 507(e) of the Code defines the "value of the net assets" as the value determined at whichever time such value is higher: (1) the first day on which action is taken by the organization which culminates in its ceasing to be a private foundation, or (2) the date on which the organization ceases to be a private foundation.

Section 1.507-1(b)(9) of the regulations requires a private foundation that transfers all of its net assets to file the annual information return required by section 6033 of the Code. The private foundation does not need to file such information return for any taxable year following the taxable year in which the last of any such transfers occurred, provided that the foundation, in such subsequent taxable years, does not hold legal or equitable title to any assets.

Section 1.507-3(a)(2)(i) of the regulations provides that a section 507(b)(2) transferee organization succeeds to the transferor's aggregate tax benefits that are attributable to the assets transferred.

Section 1.507-3(a)(9)(i) of the regulations provides that for the purposes of sections 4940 et seq. and section 507-509 of the Code, a transferee foundation shall be treated as the transferor where a private foundation transfers all of its assets to one or more private foundations which are effectively controlled (within the meaning of Section 1.482-1(a)(3)), directly or indirectly, by the same person or persons which effectively control the transferor foundation.

Section 1.507-3(a)(9)(iii), Example (2) of the regulations allows a private foundation to make Code section 507(b)(2) transfers of all of its assets to organizations exempt under section 501(c)(3), including private foundations, without creating any expenditure responsibility requirement under section 4945(h) on the transferor foundation.

Section 1.482-1A(a)(3) (formerly cited as Section 1.482-1(a)(3)) of the regulations provides the definition of "controlled" as used in section 1.507-3(a)(9)(i) of the regulations. Controlled includes "any kind of control, direct or indirect, whether legally enforceable, and however exercisable or exercised. It is the reality of the control that is decisive, not its form or the mode of its exercise.

Section 4940(a) of the Code imposes on each private foundation which is exempt from taxation under section 501(a) for the taxable year, with respect to the carrying on of its activities, a tax equal to 2 percent of the net investment income of such foundation for the taxable year.

Section 4940(c)(4)(A) of the Code provides that, for purposes of 4940 excise tax, only gains and losses from the sale or other disposition of property used for the production of interest, dividends, rents, and royalties, and property used for the production of income included in computing the tax imposed by section 511 (except to the extent gain or loss from the sale or other disposition of such property is taken into account for purposes of such tax) is taken into account in determining capital gain net income.

Section 4941 of the Code imposes excise tax on acts of self-dealing between a private foundation and any of its disqualified persons.

Section 4941(d)(1) of the Code defines self-dealing as including the sale or exchange of property between a foundation and a disqualified person and the transfer to or use by or for the benefit of a disqualified persons.

Section 4945 of the Code imposes an excise tax on a private foundation's making of any "taxable expenditure."

Section 4945(d)(4) of the Code requires that, for a transfer of assets not to be a taxable expenditure, a transferor private foundation must exercise "expenditure responsibility" under section 4945(h) on any transfer to another private foundation which is not an "exempt operating foundation" under section 4940(d)(2) of the Code.

Section 4945(h) of the Code provides in pertinent part as follows:

The expenditure responsibility referred to in subsection (d)(4) means that the private foundation is responsible to exert all reasonable efforts to establish adequate procedures (1) to see that the grant is spent sole for the purpose for which made, (2) to obtain full and complete reports from the grantee on how the funds are spent, and (3) to make full and detailed reports with respect to such expenditures to the Secretary.

Revenue Ruling 78-387, 1978-2 C.B. 270, holds that a transferee is entitled to reduce its distributable amount under section 4942 by the amount of the transferor's excess qualifying distributions when a transferee is treated as the transferor under section 1.507-3(a)(9).

Section 53.4945-6(b)(2) of the Foundation and Similar Excise Taxes Regulations provides that a private foundation's payment of the reasonable costs for services rendered, is not a taxable expenditure.

Section 53.4945-6(c)(3) and 1.507-3(b) of the regulations allow a private foundation to make a Code section 507(b)(2) transfer of its assets to an organization exempt from tax under section 501(c)(3) of the Code, including private foundations, without the transfers being taxable expenditures.

Section 53.4946-1(a)(8) of the regulations provides that for the purposes of self-dealing under section 4941, the term "disqualified person" shall not include an exempt organization described in section 501(c)(3).

ANALYSIS

Section 1.507-3(c)(1) of the regulations describes the necessary criteria in order to come within the provisions of section 507(b)(2) of the Code. First, the asset transfer must be from one private foundation to another. Second, the transfer must be pursuant to a liquidation, merger, redemption, recapitalization, or other adjustment, organization, or reorganization. In this context, "other adjustment, organization, or reorganization" includes any partial liquidation or significant distribution of assets to one or more private foundations. Third, the transfer must represent 25 percent or more of the fair market value of the net assets of the transferring foundation.

The transfer of assets from X to Y qualifies as a section 507(b)(2) transaction. First, both X and Y are private foundations. Second, the proposed transfer is an "other adjustment, organization, or reorganization" that constitutes a significant distribution of assets since it represents 100% of the net assets of X as of the date of the transfer, well exceeding the 25% threshold required by section 1.507-3(c)(2) of the regulations.

A transfer under section 507(b)(2) of the Code will not result in a termination of a private foundation's status, as such, unless the private foundation gives notice of its intent to terminate or if section 507(a)(2) is applicable. X has not given any notice of its intention to terminate and has represented it has not committed any willful acts that would cause termination under section 507(a)(2). Therefore, the transfer of assets from X to Y will not result in a termination, either voluntary or involuntary, of X's or Y's status as a private foundation under section 507(a).

Section 507(c) imposes a tax on terminating foundations. The termination tax imposed by section 507(c) does not apply to X or Y because the foundations are not terminating as a result of the transfer.

If X gives proper notice of voluntary termination under section 507(a), at least one day after the transfer, it will result in a termination under section 507(c). Section 507(c) imposes a tax on terminating private foundations based on the lower of the aggregate tax benefit or the value of the net assets of the terminating private foundation. X, as of the date of termination and the date of the commencement of the action that results in termination, will have net assets equal to zero. Accordingly, no tax will be imposed by section 507(c).

Following the transfer of assets, the transferee foundation succeeds to the aggregate tax benefit of the transferor pursuant to section 1.507-3(a)(2)(i). Therefore, Y will succeed to the aggregate tax benefit of X.

Both, X and Y have Trustees effectively controlled by V. V is the sole Trustee of X and V along with his adult children are Trustees of Y. They are "controlled" by the same persons within the meaning of section 1.482-1A(a)(3). Under section 1.507-3(a)(9)(i), if the same person or persons control two foundations, the foundations are treated as the same for the purposes of section 4940 et seq. and sections 507-509 of the Code. Therefore:

Under section 4940 of the Code, the transfer will not result in any tax on gross investment income or capital gain net income.

Under section 4941 of the Code, the transfer is not an act of self-dealing.

In accordance with sections 1.507-3(a)(9)(i) and 1.507-3(a)(9)(iii), Example (2) of the regulations, the transfer does not constitute a grant under section 4945(d)(4) of the Code for which expenditure responsibility would be required. Therefore, X does not need to exercise expenditure responsibility with respect to the transfer.

Under section 53.4945-6(b)(2) of the regulations, a private foundation's payments of its reasonable costs for services rendered is not a taxable expenditure under section 4945 of the Code. Thus, X's payment of legal, accounting, and other expenses incurred to effectuate the transfer with Y, if reasonable in amount, will not be taxable expenditures under section 4945.

Pursuant to section 1.507-3(a)(9) of the regulations, which treats the transferee as the transferor for purposes of section 4940 et seq. of the Code, the distribution requirements of section 4942 of the Code do not apply to X in the year of the transfer because such distributions will be treated as Y's distributions. However, the distribution requirements under section 4942 of the Code for the year of the transfer do apply to Y. Additionally, under Rev. Rul. 78-387, Y will succeed to the excess qualifying distributions of X.

Furthermore, pursuant to section 1.507-3(a)(9)(i) of the regulations, X will not be required to satisfy the expenditure responsibility provisions of section 4945(d)(4) of the Code for any grants made by Y after the transfer. However, Y must exercise expenditure responsibility as to any and all outstanding grants of X that required X to exercise expenditure responsibility.

Based on the information you have submitted and as the transferee foundation is recognized as exempt under section 501(c)(3) of the Code, under the facts described above we rule as follows:

1) The transfer by X of all its assets to Y will qualify as a Section 507(b)(2) transfer, and X's status as a private foundation will not terminate as a result of such transfer. Rather, X will be terminated for purposes of Section 507 when it complies with the notification and other requirements of Section 507(a)(1) of the Code the year in which it is dissolved.

2) Since X's private foundation status will not terminate as a result of the transfer, X will not be subject to any tax under Section 507(c) in the year of the transfer. Additionally, there will be no termination tax imposed under Section 507(c) of the Code upon X's termination in any tax year following the year in which the transfer is made.

3) Y, as the transferee organization, will not be treated as a newly created organization but will be treated, pursuant to Treasury Regulation Section 1.507-3(a)(1), as possessing the attributes and characteristics of X (as defined in Treasury Regulation Sections 1.507-3(a)(2), (3) and (4)). In addition, pursuant to Treasury Regulation Section 1.507-3(a)(5), the transfer by X to Y shall be counted as a qualifying distribution to the extent of X's current year's undistributed income and to the extent Y satisfies Section 4942(g) of the Code.

4) The transfer of assets from X to Y will not constitute an act of self-dealing within the meaning of Section 4941 of the Code between X and Y or their respective foundation managers.

5) The transfer of assets from X to Y will not constitute a taxable expenditure within the meaning of Section 4945(d) of the Code, and X will not be required to exercise expenditure responsibility as defined in Section 4945(h) of the Code with respect to such transfer of assets.

6) The transfer of assets from X to Y will not constitute a "sale or other disposition of property" within the meaning of Section 4940(c)(4)(A) of the Code.

Because this ruling could help resolve future questions about your federal income tax status, you should keep it in your permanent records.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Gerald V. Sack

Gerald V. Sack
Manager, Exempt Organizations
Group 4

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